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## NEW LEGISLATION ON THE SPANISH “TAX LEASE”

On December 28, 2012, the Official State Gazette published Law 16/2012, of December 27, 2012, adopting various tax measures aimed at shoring up the public finances and boosting economic activity. This law amends the “tax lease” system established for finance lease agreements, applicable to the acquisition of certain assets, including vessels that are not serially manufactured.

The new tax lease system, which took effect on January 1, 2013, replaces the former system, which is being investigated by the European Commission under State aid case no. SA.21233 C/2011 (ex NN/2011).

The key features of both the former and the new tax lease system, as well as their functioning and requirements, are summarized below.

### 1. THE TAX LEASE SUMMARIZED

“Tax lease” is the term used to describe the tax system for certain finance lease agreements (including finance leases for acquiring vessels) provided for in article 115 of the Revised Corporate Income Tax Law (the “TRLIS”).

Article 115 allows to be treated as a tax-deductible expense the finance lease installments paid to the lessor that relate to the recovery of the cost of the asset, subject to the limit of twice the maximum straight-line depreciation rates established for the assets in question, unless the lease agreement covers non-depreciable assets (article 115.6 TRLIS). The law also allows accelerated depreciation which can be started early, in particular where the asset is built over a long period of time (article 115.11 TRLIS).

In practice, the tax lease is often implemented through the creation of an Economic Interest Group (EIG), which leases a vessel to a shipping company through a bareboat charter. The EIG is allowed to accelerate depreciation of the vessel for tax purposes before the vessel enters into operation, which creates corporate income tax losses for the investors in the EIG.

Those investors thereby obtain a temporary tax benefit (the initial decrease in their corporate income tax bases) through an accelerated depreciation system. Because the investors obtain a tax advantage, they are willing to accept a lower financial return, which brings down the cost of the vessel for the shipping company.

## **2. THE FORMER TAX LEASE SYSTEM AND THE INVESTIGATION LAUNCHED BY THE EUROPEAN COMMISSION**

The tax system envisaged in sub-articles 115.6 and 115.11 of the TRLIS before Law 16/2012 took effect (the option to start early accelerated depreciation under this system, subject to authorization by the Ministry of Economy and Finance) was only applied in practice to the vessels acquired by EIGs.

In addition, to be able to apply this tax system, the transactions in question had to consist in the acquisition or construction of vessels used for carrying goods and passengers, as well as for maritime assistance, such as towage and rescue activities, or for transportation linked to other services provided at sea.

Expressly excluded from the system, however, were vessels used for fishing, sports, dredging and recreational activities, non self-propelled floating craft, port and river ferries, as well as floating platforms that are not used for carrying goods or passengers or for transportation activities in services that are not necessarily provided at sea.

Also, as noted above, the tax lease required authorization from the Ministry of Finance and Public Authorities, which would determine the time (before the asset's entry into operation) when the asset could start to be depreciated in accordance with article 115.11 TRLIS.

On July 1, 2011, the European Commission launched an in-depth investigation to determine whether the Spanish tax lease system for acquiring vessels was compatible with EU state aid rules. Although the procedure has not ended, the Commission considers that this system contains elements of state aid for the EIGs, the taxpayers that invest in them and the shipping companies that acquire the vessels, and possibly for the shipyards and certain intermediaries. If the Commission concludes that there has been unlawful aid (not previously notified to the Commission), and depending on the terms of the European Commission's final decision, the recipients of the system from 2003 to the present may be required to return the (substantial) amounts they have received under the system.

For state aid purposes, the main problem raised by the former tax lease system described here is its joint application with the "tonnage tax" system, regulated in articles 124 to 128 TRLIS, and the selective tax advantage which, in the opinion of the European Commission, this entails for EIGs and their investors. The tonnage tax system is specifically aimed at shipping companies registered on the Special Register of Vessels and Shipping Companies, and is not based on the operating income obtained by a shipping company in a fiscal year, but rather on the tonnage of the merchant fleet operated by the company, which entails a significant tax saving for the company.

The joint application of the two systems and, in particular, the exemption for vessels acquired using this arrangement from the obligation to record, upon entering the tonnage tax system, a restricted reserve in the amount of the accelerated tax depreciation (a reserve which had to be added to the tax base at the time of transfer of the vessel) meant that the

temporary tax advantage under the tax lease system turned into a definitive advantage, because the reversal of the deferred tax liability was neutralized by the application of the tonnage tax system to the EIG at the time of transfer of the vessel (article 50.3 of the Corporate Income Tax Regulations).

For this reason, although the state aid investigation procedure has not yet ended, Spain has notified the European Commission of an amended version of article 115 of the TRLIS, containing broader rules on the early accelerated depreciation mentioned above. The European Commission has welcomed the Spanish government's proposal, as set out in Law 16/2012, of December 27, 2012. The application of the new tax lease system does not prejudice the final outcome of the investigation procedure commenced by the European Commission with respect to the former system.

### 3. LAW 16/2012 AND THE NEW TAX LEASE SYSTEM

Law 16/2012 amends article 115 TRLIS, which sets out the special accelerated depreciation system for certain finance lease agreements.

The new tax lease system amends the former tax system established for the accelerated depreciation of assets in certain finance lease agreements, with the aim of complying with the authorization received from the European Commission in state aid case SA.34936 (2012/N), whereby the tax lease system has been regarded as a general measure and that it does not constitute state aid in accordance with the Treaty on the Functioning of the European Union.

In this way, the new tax lease system consists in the early and accelerated depreciation of assets acquired under certain finance lease agreements, provided that the construction period is at least 12 months and the built asset meets the customer's technical specifications, which excludes assets that are serially manufactured.

The aim therefore is for the tax lease to cover not only vessels (as occurred in practice under the former system), but also other assets such as railroads, aircraft or other assets that are not serially manufactured.

In addition, the system will apply regardless of whether the asset is manufactured inside or outside of Spain and it will apply automatically. The only formal requirement will be to provide prior notification of the application of the system to the Ministry of Finance, and prior authorization from the Ministry will no longer be required as was hitherto the case. Lastly, the option to make the anticipated deductions definitive by entering the "tonnage tax" system has been eliminated.

In particular, subprovision five of final provision one of Law 16/2012 amends subarticle 11 of article 115 TRLIS, relating to the tax system for finance lease agreements, as follows:

- It eliminates the authorization system whereby the Ministry of Finance and Public Authorities had to determine when the depreciation could start.

- It replaces that authorization system with an election system whereby any lessee may elect (by notifying the Ministry of Finance and Public Authorities) to establish that depreciation will start when the construction of the asset starts , provided that the following requirements are simultaneously met:
  - The asset must be a tangible fixed asset covered by a financial lease agreement, in which the lease installments are largely paid before construction of the asset is complete.
  - The construction period for the asset must be at least 12 months.
  - The asset must meet unique technical and design requirements and must not be serially-produced.
- It eliminates the requirement that the assets covered by the finance lease agreement must be leased to third parties not related to the EIG that uses the assets in its activity and that the EIG's members must continue to be members until the end of the tax period in which the lease ends.

In addition, Law 16/2012 adds a transitional provision (thirty-nine) to the TRLIS under which the assets with respect to which the relevant administrative authorization has been obtained in a tax period commencing before January 1, 2013 will be governed by the legislation in force as of December 31, 2012.

In tandem with the above amendments, Law 16/2012 repeals the articles in the regulations (49 and 50.3 of the Corporate Income Tax Regulations) which regulated (i) the system for authorizing early accelerated depreciation and (ii) the provision that, upon entering the tonnage system, vessels that were acquired by exercising the purchase option under a finance lease agreement the tax effects of which were subject to prior authorization by the tax authorities will not be regarded as used vessels.

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